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# The Implications of CSX and DMA

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## The Implications of *CSX* and *DMA*

by David Gamage and Darien Shanske



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In this edition of Academic Perspectives on SALT, the authors discuss parallels between the recent decisions in *Alabama Department of Revenue v. CSX* and *DMA v. Brohl*. Although the authors conclude there is no single grand theory uniting the two cases, they note ways the opinions, including a dissent and the concurrences, can inform readers as to future Court opinions.

### Introduction

This Supreme Court term has already featured two important state and local tax decisions, and we have not even gotten to *Wynne v. Comptroller*. In this column we provide some initial reflections<sup>1</sup> on *Alabama Department of Revenue v. CSX Transportation Inc.*<sup>2</sup> and *Direct Marketing Association v. Brohl*.<sup>3</sup>

### *CSX Transportation Inc.*

The background facts of *CSX* are as follows: Section 11501(b)(4) of the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act) prohibits a state from imposing “another tax that discriminates against a rail carrier.”<sup>4</sup> Alabama imposes a general sales and use tax that is based on the value of the item purchased. When railroads purchase diesel fuel, they must pay the tax. However, two competing types of businesses — motor carriers (trucks) and interstate water carriers (ships) — are exempt from paying the sales tax

on their diesel fuel purchases. The motor carriers pay a different per-gallon excise tax. Ships do not pay the excise tax; they have been exempt from the sales tax since 1959 because the state believed that the dormant commerce clause prevented it from imposing the tax.

The two questions before the Court were:

(1) When the statute forbids discrimination, to which comparison class should the lower courts look? Should the court read in a comparison class from the immediately preceding subsections of the 4-R Act (“commercial and industrial property”), or did Congress specifically not wish to include that limitation?

(2) If a court finds facial discrimination, can a state defend its policies by pointing to the operation of its larger tax system?

Regarding the comparison class issue, the Court rejected the limitation on what can constitute the class that was proposed by Alabama and that had also been proposed by Justices Clarence Thomas and Ruth Bader Ginsburg in dissent the last time this case was before the Court.<sup>5</sup> The anti-discrimination provision at issue is in subsection (b)(4), which does not explicitly define the proper comparison class. However, subsections (b)(1)-(3) explicitly indicate a comparison class of commercial and industrial property. The majority found that this limitation does not carry over from the first three subsections to the last, primarily because the earlier subsections were specifically about the property tax and the final residual provision is not so limited.

Once the Court found that this limitation did not restrict subsection (b)(4), the question became what constitutes a comparison class. Here the Court provided only broad guidance. On the one hand, the analysis of what constitutes a comparison class cannot be the same as would be performed in connection with the equal protection clause because, for economic matters, the equal protection clause permits very fine distinctions. As Justice Antonin Scalia explained, if this analysis were imported into the 4-R Act, it “would deprive subsection (b)(4) of all real-world effect, providing protection that the equal protection clause already provides.”<sup>6</sup> The proper comparison class must take into account the purpose of the 4-R Act, which is (and here

<sup>1</sup>Some of these impressions and ideas were first presented in posts for SCOTUSBlog and a column for the *Daily Journal*.

<sup>2</sup>No. 13-553, 575 U.S. \_\_\_\_ (2015).

<sup>3</sup>No. 13-1032, 575 U.S. \_\_\_\_ (2015).

<sup>4</sup>49 U.S.C. section 11501(b)(4).

<sup>5</sup>562 U.S. 277 (2011).

<sup>6</sup>*Id.* at 6.

the opinion cites the purpose of the statute) to “restore the financial stability of the railway system of the United States, [while] foster[ing] competition among all carriers by railroad and other modes of transportation.”<sup>7</sup> Given this purpose, the Court agreed that competitors, such as motor carriers, can be an appropriate comparison class. As for other possible comparison classes, the Court put that question to the side, stating that “sufficient unto the day is the evil thereof.”<sup>8</sup>

Regarding proper discrimination analysis, the Court explained that “it does not accord with ordinary English usage to say that a tax discriminates against a rail carrier if a rival who is exempt from that tax must pay *another* comparable tax from which the rail carrier is exempt.”<sup>9</sup> In other words, how can there be unlawful discrimination if in reality the railroads were no worse off than their competitors? The Court therefore “could not approve” the Eleventh Circuit’s refusal to consider Alabama’s argument that its fuel excise tax is the “rough equivalent” of its sales tax on diesel fuels.<sup>10</sup> Though the Court was “inclined to agree” that this is not the kind of analysis that courts are likely to do well, it is nevertheless the duty of courts to try, because that is the task Congress assigned to the courts “by drafting an antidiscrimination command in such sweeping terms.”<sup>11</sup>

Both for the questions of comparison class and the scope of analysis, Scalia’s opinion adopted a statutory interpretation that requires courts to apply broad standards. Thomas’s dissent does more than argue for his reading of the statute; he also needles the majority about reaching a “predictably unworkable” result.<sup>12</sup>

We have one observation about this case on its own terms, and another comment about this case in comparison to *DMA*. First, the dormant commerce clause also forbids discrimination in taxation, and thus the Court has already analyzed what constitutes discrimination in taxation at some length. Also, in the dormant commerce clause cases, as briefly noted in the opinion, the Court has long accepted the possibility that states can defend themselves from a charge of discriminatory taxation by showing that there is some other compensating tax. By referring back to a dormant commerce clause case from 1932,<sup>13</sup> the majority opinion appears to accept that this piece of conceptual analysis is sound. Yet a lot has happened since 1932. In particular, the Court developed the so-called complementary tax doctrine, complete with its own three-part test, which has been applied fairly recently.<sup>14</sup> The doctrine was discussed in the

briefs, including in the brief for the United States as amicus supporting neither party. This is especially significant because the Court’s disposition of this case largely followed that proposed by the United States in its brief and at oral argument.

What does it mean that the complementary tax doctrine made no appearance in the majority opinion? Rather than reference the doctrine, the Court used a form of the phrase “rough equivalent” twice, along with “roughly comparable,” to describe what the Eleventh Circuit must assess when comparing the different Alabama taxes. Is this standard stricter or looser than the complementary tax doctrine? Is this doctrine not mentioned because the Court finds it unsatisfactory or applicable only to dormant commerce clause cases?

We think this rough equivalence represents a standard that is lower than that applied in the recent complementary tax cases. The complementary tax doctrine has three prongs: First, a special out-of-state burden must be identified. Second, the out-of-state surcharge must approximate, but not exceed, the identified burden. Third, the event that triggers the in-state and out-of-state tax must be “substantially equivalent.”<sup>15</sup> To be sure, just reviewing the three prongs, the complementary tax doctrine could be essentially the same as asking whether two taxes are “roughly comparable.” Nevertheless, we think the Court’s rhetoric and at least one recent decision indicate the complementary tax doctrine is stricter than just asking about rough comparability.

In *Associated Industries of Missouri v. Lohman*, the Court explained, “Under our cases, unless one of several narrow bases of justification is shown . . . actual discrimination, wherever it is found, is impermissible, and the magnitude and scope of the discrimination have no bearing on the determinative question of whether discrimination has occurred.”<sup>16</sup> If the magnitude and scope are irrelevant, how can rough equivalence suffice?

The facts of *Lohman* indicate that this strictness is not mere rhetoric. In *Lohman*, Missouri imposed a 1.5 percent average use tax at the state level to compensate for the sales tax imposed by some 1,000 localities. The Court found that this added use tax violated prong two of the complementary tax doctrine — a statewide average did not eliminate the discrimination happening on all of the transactions on which imported goods were charged more than local goods. This was so even though, by necessity, any discrimination evened out across the state and was arguably roughly equivalent. This is not to say that *Lohman* cannot be distinguished, just that it is one example of a line of cases that apply the complementary tax doctrine in a way not obviously consistent with the roughly equivalent standard.

<sup>7</sup>*Id.* at 6 (citing 4-R Act section 101(b)(2)).

<sup>8</sup>*Id.*

<sup>9</sup>*Id.* at 8.

<sup>10</sup>*Id.* at 9.

<sup>11</sup>*Id.*

<sup>12</sup>*Id.* at 11 (Thomas, J., dissenting).

<sup>13</sup>*Gregg Dyeing Co. v. Query*, 286 U.S. 472, 479-480 (1932).

<sup>14</sup>*See, e.g., Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996).

<sup>15</sup>*See, e.g., Oregon Waste Systems Inc. v. Dep’t of Environmental Quality of Oregon*, 511 U.S. 93, 103 (1994).

<sup>16</sup>511 U.S. 641, 644 (1994).

## DMA

The background facts are as follows: Generally speaking, the Colorado statute at issue in *DMA v. Brohl* requires that out-of-state vendors that do not need to collect the use tax (because of *Quill*<sup>17</sup>) must provide their customers with a notice that the customers owe the use tax and requires that the retailers report the amount of individual Colorado residents' purchases to the Department of Revenue. The Supreme Court held that the Tax Injunction Act (TIA; 28 U.S.C. section 1341), does not bar a federal court from enjoining the operation of this statute because enjoining this reporting obligation does "not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law." The Court reasoned that the TIA must be understood on the basis of the federal Anti-Injunction Act (AIA), which in turn is interpreted in light of federal tax law. Notice requirements occur before assessments in the federal code and are therefore not covered by the TIA. Case closed.<sup>18</sup>

Full disclosure: We worked on an amicus brief taking Colorado's side in this case, so we are in a good position — perhaps too good — to take a critical look on its reasoning.

Consider the following: In *CSX*, seven justices, including Scalia, the author of *CSX*, accepted the premise that the 4-R Act was to be interpreted broadly, consistent with its purpose, even if this meant that courts would be tasked with applying broad standards. Thomas dissented in *CSX*, explaining how a word-by-word analysis of the 4-R Act could produce an easier-to-apply rule, a rule consistent with a narrower construal of the act's purposes — namely, protecting railroads from discrimination relative to all other businesses. Nevertheless, in *DMA*, a unanimous Court, in an opinion written by Thomas, eschewed looking at the broader purpose of the TIA and embraced a technical reading that provides a seemingly easy-to-apply rule. What changed? Presumably Thomas believes that he applied the same interpretive method to resolve both cases. Indeed, one might have thought that the TIA, with its implications for federalism, would have merited the broader treatment.

There are several clues to resolving these riddles in the majority and concurring opinions. First, regarding federalism concerns, one must remember that they are considered so important that the Court has not found them to be fully encapsulated by the TIA. Rather, the TIA is only a partial codification of long-standing comity concerns that should guide courts and which guided the Supreme Court as recently as *Levin v. Commerce Energy* in 2010.<sup>19</sup>

Regarding comity concerns, the Court in *DMA* did not reach the issue. Thus, the broad argument for a federal court to stay its hand regarding Colorado's statute has not been fully weighed. And it seems plausible that the Court would be unwilling to shield all novel tax collection statutes using the TIA while also being open to permitting this particular statute to be shielded from federal court interference because of comity considerations. After all, this statute is arguably not very burdensome and is addressing an urgent fiscal matter. Further, this is a curious circumstance in which the Tenth Circuit can already point to the adequate remedy having been provided to the DMA by state courts. That said, whether Colorado will be able to win on the issue is quite another matter, because the state did not argue comity before the lower courts. But we think other states should not be so quick to abandon making a comity argument.

The second reason to consider that the holding of *DMA* is narrow is that the court repeats twice that it is interpreting the statute in a rigid manner that favors "clear boundaries" because it is a jurisdictional statute. The implication being that a different interpretive rubric might have otherwise been appropriate.

Finally, there is Ginsburg's concurrence, joined by Justices Stephen G. Breyer and Sonia Sotomayor. Ginsburg emphasizes that the Colorado statute imposed a notice requirement on a party that, by definition, was not obligated to remit the tax.<sup>20</sup> If a party that did have such an obligation, for instance an employer obligated to withhold, were to challenge a similar reporting requirement, then this would be a different case. In other words, Colorado's reporting statute lost the protection of the TIA for the very reason it was instituted to begin with — the entities that need to report the use tax obligation cannot be compelled to collect the tax themselves.

This brings us to Justice Anthony Kennedy's concurrence, which takes direct aim at *Quill*. Naturally, this concurrence has received a great deal of attention. Regarding this extraordinary concurrence, we have three observations.

First, Kennedy's critique of *Quill* in part tracked the opinions of courts below and commentators who have urged that *Quill* is to be read narrowly.<sup>21</sup> For instance, Kennedy emphasized the degree to which *Quill* was upheld on the grounds of *stare decisis* and that the decision itself contains limiting language. When lower courts have accepted this reasoning, they have done so in cases that, in effect, limited *Quill*. These decisions limit *Quill* to the use tax context and do not apply it to the corporate income tax.

<sup>17</sup>*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

<sup>18</sup>Maybe. *DMA*, which limits the protection of the TIA (and seemingly the federal AIA), may well be reconsidered sooner rather than later because of unanticipated consequences. See, e.g., Marie Sapirie, "The Effect of *Direct Marketing Association*," *State Tax Notes*, Mar. 30, 2015, p. 780.

<sup>19</sup>560 U.S. 413 (2010).

<sup>20</sup>*DMA*, *slip op.* at 1-2 (Ginsburg, J., concurring).

<sup>21</sup>Compare *DMA*, *slip op.* at 2 (Kennedy, J., concurring) ("In other words, the *Quill* majority acknowledged the prospect that its conclusion was wrong when the case was decided") with *Tax Comm'r of State v. MBNA America Bank, N.A.*, 640 S.E.2d 226 (W.Va. 2006); John A. Swain, "State Income Tax Jurisdiction: A Jurisprudential and Policy Perspective," 45 *Wm. & Mary L. Rev.* 319 (2003).



If the Tenth Circuit were moved by Kennedy's reasoning, and given that it cannot overturn *Quill*, one sensible option would be for the Tenth Circuit to accept Colorado's contention that the strict *Quill* rule should not be expanded to apply to a notice and reporting requirement.<sup>22</sup>

Second, Kennedy outlined the argument for overturning *Quill* by appealing to a recent case that also overturned relatively recent precedent. That 2009 case, *Pearson v. Callahan*,<sup>23</sup> is, in our opinion, an interesting analogy. In *Pearson*, the Court unanimously overturned the order of analysis it had established for adjudicating some section 1983 suits. That order had been established by a 2001 opinion, *Saucier v. Katz*, which was written by Kennedy.<sup>24</sup> The *Saucier* ordering rule was reasonable, but always vulnerable to the critique that it was overly rigid, and experience confirmed the critique. Kennedy argued that as with *Quill*, the initial conceptual analysis was always questionable as being rigid. Experience has confirmed that critique. And, more dramatically than in *Pearson*, the demonstration of the problems with *Quill* has come by means of an epochal change in the structure of our economy.<sup>25</sup>

Finally, there's Kennedy's somewhat puzzling conclusion: "The legal system should find an appropriate case for this Court to reexamine *Quill*." What is Kennedy asking for? A challenge to New York's "Amazon" law was just before the Court in the fall of 2013, and the Court denied a petition for certiorari. Here is one possible problem that might have concerned Kennedy: New York's Amazon law, which established nexus through in-state affiliates, was designed to satisfy the *Quill* test. The briefing largely addressed whether New York's statute was true to *Quill*. Perhaps what a state needs to argue is that its Amazon law is true to *Quill* and that, further, *Quill* should be overturned.

This raises another question: Would a state directly benefit from overturning *Quill* if its Amazon law were struck

down? A state would be in that position if it also had a statute on the books requiring sellers without physical presence to collect use tax as soon as imposing that obligation is constitutionally permissible. California has such a statute, and Colorado arguably does as well.<sup>26</sup>

Suppose Colorado does indeed have such a statute. In that case, if, for example, on remand, the Tenth Circuit were to proceed to the merits of Colorado's case, then whichever side wins, there could be a vehicle for the Court to reconsider *Quill* because Colorado would directly benefit from an alternative holding overturning *Quill* and the Court could direct the parties to address the question whether *Quill* should be overturned.<sup>27</sup> Of course, assuming Kennedy's concerns are shared by a majority on the Court, a less dramatic solution could be to just uphold Colorado's statute on the merits.

### Conclusion

Ultimately, we do not think there is a single grand theory explaining CSX and DMA. Nevertheless, we do think it is significant that the Court adopted such different approaches to two federal statutes, because this indicates that the particular content and context of the statutes drove the choice of interpretive rubric. Both decisions are notable in not only failing to resolve a major issue in state and local taxation, but actually unsettling such issues. In the case of *Alabama Dep't of Revenue v. CSX*, we have the prospect of reconsideration of the complementary tax doctrine. *DMA v. Brohl* directly implicates the interpretation of the TIA and AIA, does not address the interpretation of the comity doctrine at all, and (most strikingly) through Kennedy's concurrence indicates that the Court may, at long last, be willing to reconsider *Quill*. ☆

<sup>22</sup>For another option for how *Quill* might be interpreted so as to narrow and limit its impact, see Gamage and Devin J. Heckman, "Better Way Forward for State Taxation of E-Commerce," 92 *B.U. L. Rev.* 483 (2012).

<sup>23</sup>555 U.S. 223 (2009).

<sup>24</sup>533 U.S. 194 (2001).

<sup>25</sup>*DMA*, slip op. at 3 (Kennedy, J., concurring) ("It is unwise to delay any longer a reconsideration of the Court's holding in *Quill*. A case questionable even when decided, *Quill* now harms States to a degree far greater than could have been anticipated earlier").

<sup>26</sup>Cal. Rev. & Tax Code section 6203(c); Colo. Rev. Stat. section 39-26-102(3). Washington is considering a similar statute; see Jordan Schrader, "Washington Covets Online Sales Tax Revenue, May Take the Risk of Budgeting for It," *The News Tribune*, Apr. 4, 2015.

<sup>27</sup>Cf. *Pearson v. Callahan*, 555 U.S. 223, 231 (2009) ("As noted, the Court of Appeals followed the *Saucier* procedure [that was then required]. The *Saucier* procedure has been criticized by Members of this Court and by lower court judges, who have been required to apply the procedure in a great variety of cases and thus have much firsthand experience bearing on its advantages and disadvantages. Accordingly, in granting certiorari, we directed the parties to address the question whether *Saucier* should be overruled").